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VIA MESSENGER

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May 20, 2002

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VIA MESSENGER

The Honorable Marlene H. Dortch
Secretary
Federal Communications Commission
236 Massachusetts Avenue, N.E.
Suite 110
Washington, D.C. 20002

Re: *Ex Parte* Presentation re: Leasing of Customer Premises Equipment

Dear Ms. Dortch:

Pursuant to Section 1.1206 of the Commission's rules, the original and one copy of this letter are being filed as notice that the people listed below met on Friday, May 17, 2002, with members of the Office of General Counsel and the Wireline Competition Bureau. Please date-stamp the second copy of the letter and return it to the messenger that delivered this package.

Attending from the Office of the General Counsel were Michele Ellison, Deputy General Counsel; Richard Welch, Associate General Counsel; and Debra Weiner, Assistant General Counsel. Attending on behalf of the Wireline Competition Bureau was Richard Lerner, Chief of Staff. Attending on behalf of Lucent Technologies were Albert Halprin, Partner, from Halprin, Temple, Goodman, and Maher; Louis Bonacorsi, Partner, and James Bennett, Associate, from Bryan Cave LLP; Martina Bradford, Partner, from Akin, Gump, Strauss, Hauer and Feld L.L.P.; and Ralph Everett, Partner, and Neil Fried, Associate, from Paul, Hastings, Janofsky and Walker LLP.

During the meeting, the parties discussed the status of state litigation regarding the leasing of customer premises equipment (CPE). The representatives on behalf of Lucent explained that Lucent provided CPE at the direction of the FCC, and conducted that business in accordance with the FCC's requirements. The representatives on behalf of Lucent believe that aspects of the plaintiffs' complaint directly challenge previous findings of fact and law made by the FCC, and thus should be preempted.

In particular, the parties discussed the possibility of filing a petition for declaratory ruling or supplementing the record of the prior filing concerning preemption of certain state actions involving CPE.

Very truly yours,

Neil R. Fried
for PAUL, HASTINGS, JANOFSKY & WALKER LLP
*Counsel for Lucent Technologies Inc.*

cc (by messenger): Michele Ellison
Richard Welch
Debra Weiner
Richard Lerner

(by U.S. Mail): Stephen Tillery
Robert King
Michael Marker
Mathew Armstrong
Lisa Kernan

Carr, Korein, Tillery, Kunin, Montroy & Glass
Gateway One Building
701 Market Street, Suite 300
St. Louis, MO 63101

# Presentation
# on Customer Premises Equipment Leasing
# to the Office of General Counsel
# of the Federal Communications Commission

## Lucent Technologies

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**April 17, 2002**

# Background

- AT&T and Lucent entered the customer premises equipment ("CPE") leasing business in 1984 at the direction of the FCC, and conducted that business in accordance with the FCC's requirements—including the *Implementation Order* that was part of the *Second Computer Inquiry*.

- Plaintiffs' nationwide class action lawsuit alleges that AT&T and Lucent violated various consumer protection laws through their leasing of CPE to embedded-base customers in compliance with the FCC's *Implementation Order*.

- Plaintiffs' claims relate only to customers that were leasing CPE from AT&T as of January 1, 1984. The suit does not extend to any customers that began leasing CPE from AT&T after that date.

- AT&T's leasing of CPE to these embedded-base customers was highly regulated by the FCC under its *Implementation Order*. **AT&T should not incur liability under state law for complying with FCC requirements.**

- **In March 1999, the trial court dismissed the Plaintiffs' claims.** The court expressly held that the Plaintiffs' claims were preempted by FCC regulation of the leasing of CPE by embedded-base customer. Plaintiffs filed a motion requesting the court to reconsider the dismissal.

- **In May 1999, the FCC filed an *amicus* brief with the trial court.** The FCC declined to address the merits of Plaintiffs' claims in its brief, but stated that the FCC only intended to preempt state utility regulation of CPE and did not preempt application of state consumer protection laws to the CPE leasing industry.

- **Citing the FCC's *amicus* brief, the trial court reinstated Plaintiffs' suit.**

- In November 2001, long after the FCC filed its *amicus* brief, the Plaintiffs filed a Third Amended Complaint and served expert witness reports shedding further light on the true nature of their claims. The Third Amended Complaint demonstrates that certain claims in the Plaintiffs' complaint are not rooted in consumer protection law, but instead amount to utility-like regulation of CPE lease rates.

- **As a result, AT&T and Lucent are requesting the FCC to revisit the preemption issue.**

# Plaintiffs' Class Action Suit

- The Plaintiffs are alleging that:
  - The CPE lease rates that AT&T charged embedded-base CPE customers were unreasonably high;
  - AT&T held market power in the CPE market, and, as a result of this market power, AT&T had a particular duty under consumer protection laws to charge cost-based CPE lease rates to embedded-base CPE customers; and
  - AT&T did not provide embedded-base CPE customers with adequate notice of their options regarding leased CPE.
- According to Albert Halprin, the Chief of the Common Carrier Bureau when the FCC detariffed CPE:

> [B]oth the prayer for relief and the measures that the plaintiffs and their experts insist should have been in place add up to nothing more than an unwarranted attempt to retroactively re-regulate the CPE marketplace. Such measures are inconsistent with, and would violate, both the letter and spirit of the FCC's rules and orders, which had the affect of pre-empting any state, local or federal attempts to apply such "special" regulatory treatment to AT&T's provision of residential CPE.

# FCC Regulation of CPE Leasing

- In the *Implementation Order,* which the FCC issued in the *Second Computer Inquiry*, the FCC adopted an extensive regulatory framework to govern the detariffing of CPE, the leasing of CPE to embedded-base customers, and the opening of the CPE market to competition. The FCC:
  - determined that AT&T did not have market power in the CPE market and that the CPE market was competitive;
  - mandated the CPE lease rates charged by AT&T during the detariffing transition period;
  - preempted states from regulating the embedded-base CPE leasing rates following the transition period;
  - required AT&T to poll all of its customers to determine whether the customers wished to continue to lease CPE from AT&T; and
  - ratified the notices used by AT&T to inform CPE lease customers of their options regarding leased CPE.

# Third Amended Complaint

- After the FCC filed its *amicus* brief, the Plaintiffs filed a Third Amended Complaint and submitted expert reports which explained the following about the nature of their claims:
  - The class action only includes embedded-base CPE lease customers that began leasing CPE from AT&T during the detariffing transition period.
  - The Plaintiffs allege that the FCC-mandated notice provided to embedded-base lease customers was inadequate and misleading.
  - The Plaintiffs' New Jersey consumer protection law claim of unreasonable CPE lease pricing is akin to direct rate regulation in that it does not require any showing of fraud or deception.
  - The Plaintiffs' theory under the New Jersey consumer protection law asks the trial court to determine that AT&T had market power in the CPE market.
- The FCC regulated AT&T's leasing of CPE to embedded-base customers and each of these claims is inconsistent with that regulation. Therefore, these claims are preempted. Alternatively, AT&T and Lucent ask the Commission to review these issues under its primary jurisdiction.

## Requested Relief

- For these reasons, AT&T and Lucent ask the FCC expeditiously to issue a declaratory ruling concluding that:
  - these claims are preempted; and/or
  - these claims fall within the primary jurisdiction of the FCC.
- The claims that the trial court is preempted from considering and/or that fall within the primary jurisdiction of the FCC are:
  - claims relying on a finding of market power in the CPE market;
  - claims related to the rates that AT&T charged its embedded-base CPE lease customers; and
  - claims related to the notice/polling provided to embedded-base lease customers.

# Conclusion

- The trial court currently is considering whether to find AT&T liable for complying with the *Implementation Order*, even though the trial court does not have jurisdiction to review the merits of prior FCC decisions.

- If the trial court rules in favor of the Plaintiffs, AT&T's nationwide liability could be in the billions of dollars, and AT&T will be subject to conflicting mandates from the trial court and the FCC.

- To avoid setting a precedent that is prejudicial to the FCC's future assertion of jurisdiction, the FCC should intervene in the instant proceeding to enforce its jurisdiction. The FCC expressly should preempt state action regarding matters over which the FCC has primary jurisdiction under the Communications Act. The FCC should not permit the trial court to find AT&T liable for complying with FCC mandates.

# History of Proceeding

| | |
|---|---|
| **Sept. 5, 1996** | Complaint filed by Donna Crain against Lucent in Illinois state court seeking damages for "confusion, inconvenience, an unnecessary increase in costs" allegedly caused by telephone leasing practices. |
| **Oct. 8, 1997** | Seconded Amended Complaint filed seeking to expand suit to a class action and alleging violations of a variety of state statutes and common law. |
| **March 10, 1999** | Trial court dismissed the suit stating that Plaintiffs' claims are preempted by the FCC's *Second Computer Inquiry.* |
| **April 8, 1999** | Plaintiffs filed Motion to Reconsider dismissal of suit. |
| **May 24, 1999** | FCC files to participate in trial court reconsideration proceeding as *amicus curiae* and initially refrains from seeking primary jurisdiction over matter. |

| | |
|---|---|
| **May 24, 1999** | AT&T and Lucent filed Motion for Declaratory Ruling with the FCC seeking a declaration by the FCC that it has primary jurisdiction over the issues underpinning the suit. |
| **July 2, 1999** | Trial court vacated its earlier dismissal of the suit and certified the class action. |
| **Nov. 14, 2000** | On appeal, Illinois appellate court affirms the trial court's order vacating its earlier dismissal of the suit. |
| **Nov. 5, 2001** | Third Amended Complaint filed seeking to expand class action to encompass all AT&T lease customers nationwide. |
| ***Summer 2002*** | *Parties anticipate that suit will be tried before a jury.* |

IN THE CIRCUIT COURT
FOR THE THIRD JUDICIAL CIRCUIT
MADISON COUNTY, ILLINOIS



| | | |
|---|---|---|
| DONNA CRAIN, et al., | ) | |
| | ) | |
| Plaintiffs, | ) | |
| | ) | |
| v. | ) | Case No. 96-LM-983 |
| | ) | |
| LUCENT TECHNOLOGIES, et al., | ) | |
| | ) | |
| Defendants. | ) | |

**MOTION OF THE**
**FEDERAL COMMUNICATIONS COMMISSION**
**FOR LEAVE TO APPEAR AND PARTICIPATE AS AMICUS CURIAE**

The Federal Communications Commission ("FCC" or "agency"), by and through its undersigned attorneys, hereby moves the Court for leave to appear as amicus curiae, to file the Memorandum tendered with this motion, and to participate further in this litigation as may be of assistance to the Court.

As set forth in the Memorandum filed in support of this motion, the FCC believes that the Court may benefit from consideration of the FCC's views on the issues pending before the Court, specifically the meaning of certain FCC orders concerning the regulation of customer premises equipment to this case. Given the FCC's responsibilities for interpreting and implementing its orders,

and its concern with how those orders are construed, the agency has a strong interest in the outcome of this case.

Respectfully submitted,

W. CHARLES GRACE
United States Attorney
For The Southern District of Illinois

MICHAEL THOMPSON
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(618) 628-3700

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PROOF OF SERVICE

| | | |
|---|---|---|
| DONNA CRAIN, et al., Plaintiffs, | ) | |
| v. | ) | Case No. 96-LM-983 |
| LUCENT TECHNOLOGIES, et al., Defendants. | ) | |

The undersigned hereby certifies that she/he is an employee in the office of the United States Attorney for the Southern District of Illinois and is a person of such age and discretion as to be competent to serve papers.

That on May 24, 1999, she/he served a copy of the attached:

**MOTION OF THE FEDERAL COMMUNICATIONS COMMISSION FOR LEAVE TO APPEAR AND PARTICIPATE AS AMICUS CURIAE AND MEMORANDUM OF FEDERAL COMMUNICATIONS COMMISSION AS AMICUS CURIAE**

by placing said copy in a postpaid envelope addressed to the person(s) hereinafter named, at the place(s) and address(es) stated below, which is/are the last known address(es), and by depositing said envelope and contents in the United States Mail at 402 W. Main Street, Suite 2A, Benton, Illinois 62812.

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Janine Tredley

IN THE CIRCUIT COURT
FOR THE THIRD JUDICIAL CIRCUIT
MADISON COUNTY, ILLINOIS

| | | |
|---|---|---|
| DONNA CRAIN, et al., Plaintiffs, | ) | |
| v. | ) | Case No. 96-LM-983 |
| LUCENT TECHNOLOGIES, et al., Defendants. | ) | |

**MEMORANDUM OF FEDERAL COMMUNICATIONS COMMISSION AS AMICUS CURIAE**

The Federal Communications Commission respectfully submits this memorandum as amicus curiae in support of the plaintiffs' motion for reconsideration of the Court's March 10, 1999, order ("ORDER") dismissing the complaint on grounds that the claims were preempted by decisions adopted by the Commission. Although it takes no position on the merits of the claims, the Commission believes that the Court erred in holding that the Commission had preempted those claims.

**BACKGROUND**

Telephone companies historically have offered services and facilities to the public under tariffs showing the charges and regulations governing their use. As a general rule, the companies have filed tariffs with the FCC offering interstate and foreign service, and with state utility commissions offering intrastate service. 47 U.S.C. 152(b), 203(a). See Louisiana Public Service Commission v. FCC, 476 U.S. 355 (1986). Telephone terminal equipment, known commonly as customer premises equipment ("CPE"), typically was bundled into the tariffed service offerings at both levels of regulation, although primarily at the state level, and CPE prices often were

subsidized by monopoly telephone service revenues.

In relatively recent times, the FCC has opened most communications markets to competition, and the market for CPE has been particularly responsive to that opening. Telephone sets and more sophisticated terminals have been available for at least 20 years from many sources other than the telephone companies. In a rulemaking proceeding that was completed just before the entry of the antitrust consent decree that broke up the former Bell System, the FCC decided that CPE should be unbundled and removed from tariff regulation and that telephone companies selling or leasing CPE should do so in a deregulated marketplace environment. Second Computer Inquiry, 77 FCC 2d 384, 84 FCC 2d 50 (1980), 88 FCC 2d 512 (1981), aff'd, Computer & Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983). The Commission concluded that a telephone company "should have the same regulatory status in marketing CPE as any other equipment vendor...." 77 FCC 2d at 446.

In light of the dual federal-state tariffing scheme, the Commission had to preempt some state regulation of CPE in order to make its deregulatory policy effective. If the state agencies continued to require telephone companies to offer CPE under tariff, the FCC's regime as a practical matter could not succeed. The FCC decided to preempt the states from regulating, however, "only to the extent that their terminal equipment regulation is at odds with the regulatory scheme we have set forth." 84 FCC 2d at 103. That regulatory scheme "essentially involves the removal of traditional utility type regulation over CPE, and the requirement that if carriers of the Bell System choose to provide CPE, they do so pursuant to the structure we have prescribed." 88 FCC 2d at 523.

The Commission thus declared that "utility regulation of CPE is contrary to the national

public interest" and that states may not impose such regulation. 88 FCC 2d at 541 n. 34 (emphasis added). But it did not preempt all state law that might apply to the CPE business, and it recognized that some states might choose "to impose additional safeguards to protect their citizens." 88 FCC 2d at 541. The District of Columbia Circuit affirmed the Commission's preemption decision on the assumption that the Commission had ordered that "charges for CPE be completely severed from transmission rates on both federal and state levels," 693 F.2d at 215,and that the states were required only "to remove CPE charges from their tariffs...," 693 F.2d at 214.

This lawsuit, filed more than a decade after the Commission detariffed CPE and placed telephone companies on the same footing as other providers of CPE, challenges leasing practices and contracts under which AT&T and Lucent Technologies, Inc. provide terminal equipment to consumers. It does not seek to subject CPE to tariff regulation at the state level or to rebundle CPE with AT&T's transmission services.

**THE FCC'S POSITION ON PREEMPTION**

The Commission has no expertise in Illinois law as it might apply to the sale or lease of CPE -- or, indeed, to any other commodity offered on a competitive basis. The Commission therefore takes no position on the merits of the claims, or even on whether the laws invoked by the plaintiffs apply to the sale or lease of CPE. To the extent that those laws would apply generally to the sale or lease of CPE by companies other than telephone companies, however, the FCC has not preempted their application to the telephone companies.

The Commission may preempt state actions that are inconsistent with and would undermine federal policies and orders the Commission has adopted pursuant to its statutory authority.

Fidelity Federal Savings & Loan Ass'n v. de la Cuesta, 458 U.S. 141 (1982)(de la Cuesta). The Commission acted within its statutory authority when it required the detariffing of CPE at the federal level; and its preemption of state tariffing was affirmed as necessary to effectuate the federal policy. See Computer & Communications Industry Ass'n v. FCC, 693 F.2d at 214-18.

But the Commission may not justify a broad preemption of state action merely by showing that some state regulation would frustrate its regulatory goals. Rather, the FCC must tailor any preemption order "to preempt only such state regulations as would negate valid FCC regulatory goals." People of California v. FCC, 905 F.2d 1217, 1243 (9th Cir. 1990). The Commission must express its intention to preempt particular state actions and show that preemption is necessary if its decision is to displace state law. Id. See also de la Cuesta, 458 U.S. at 154. The FCC expressed no such intention and made no such showing with respect to preemption of state regulation of CPE vendors outside the public utility tariffing context.

Indeed, the Commission was careful to state that it was preempting the states "only to the extent that their terminal equipment regulation is at odds with the regulatory scheme we have set forth." 88 FCC 2d at 523 (quoting 84 FCC 2d at 103). And the regulatory scheme it sought to protect from inconsistent state action involved only "the removal of traditional utility type regulation over CPE...." 88 FCC 2d at 523. See also 88 FCC 2d at 541-42 & n.34 ("Our decision does not foreclose state authorities from establishing protections for the benefit of state ratepayers."). The FCC thus preempted state tariff regulation of CPE under public utility statutes; but it did not intend to preempt the application of more general state laws to telephone companies that provide CPE in a competitive market.

Apart from the clear limitations it expressed as to its preemption intentions in the Second Computer Inquiry orders, the Commission in the analogous context of detariffing interexchange services stated explicitly that state consumer protection and contract law would apply after detariffing:

> After our policy of complete detariffing has been implemented, carriers ... will be subject to the same incentives and rewards that firms in other competitive markets confront.... Moreover, when [these services] are completely detariffed, consumers will be able to take advantage of remedies provided by state consumer protection laws and contract law against abusive practices.

Policy and Rules Concerning the Interstate, Interexchange Marketplace, 11 FCC Rcd 20730, 20733 (paras. 4, 5) (1996), review pending, MCI Telecomm. Corp. v. FCC, D.C. Circuit No. 96-1459. Here, too, the Commission intended the carriers to be "subject to the same incentives and rewards" that other firms in competitive markets confront when they offer detariffed CPE -- including "remedies provided by state consumer protection laws and contract law." 11 FCC Rcd at 20733.

This degree of preemption is appropriate to the substantive actions the Commission took in detariffing CPE. The Commission sought to sever the link between communications services, which continued to be dominated by a limited number of carriers, and the sale or lease of CPE, which already had become a marketplace commodity available from such non-telephone company vendors as Radio Shack and Walmart. Unbundling carrier-provided CPE from transmission services, removing it from tariff regulation, and subjecting it to the constraints of the market would protect communications service consumers from the costs of cross subsidizing carrier CPE activities through excessive transmission rates; and these actions also would further CPE

competition itself as carriers vied for customers with non-carriers. As the Commission said, "detariffing of CPE will allow all equipment vendors to compete on an equal basis in responding to market conditions." Second Computer Inquiry, 77 FCC 2d at 446.

Achieving these purposes on a national basis required the preemption of state tariff regulation. A continuation of state tariffing of CPE both would preserve the problems of bundling and possible cross-subsidization and would deter the effective competition that the Commission sought. But preempting generally applicable consumer protection and contract laws was not necessary to achieve those purposes, and, indeed, would have been inconsistent with the Commission's objective of allowing all CPE vendors to compete on an equal basis subject to the same set of constraints and freedoms. Selectively preempting laws that constrain other CPE vendors would have given an advantage to telephone company activities in the CPE market, contrary to the Commission's objective.

It is true that the Commission's implementation of its detariffing decision included some transitional limitations and requirements that constrained the telephone companies -- AT&T in particular -- in their initial offerings of CPE. See Procedures for Implementing the Detariffing of CPE, 95 FCC 2d 1276 (1983). The Commission sought through those actions to ensure that AT&T would not take initial advantage of its dominant CPE position and to determine appropriate accounting arrangements for the transfer of embedded CPE within the Bell System as the divestiture occurred. But the FCC did not prescribe lease rates for CPE; and it made clear that AT&T would be free from even the initial implementing restraints on lease rates after the transition ended (in two years after the divestiture in 1984). 95 FCC 2d at 1300, 1335. The Commission made no determinations with respect to AT&T's lease rates